Supreme Court, U.S.
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In The

Supreme Court of the United States

EDWARD H. ARNOLD,

Petitioner,

v.

KPMG LLP, and
SIDLEY AUSTIN BROWN & WOOD LLP,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

MICHAEL J. AVENATTI
EAGAN, O'MALLEY & AVENATTI LLP
450 Newport Center Drive
Second Floor
Newport Beach, California 92660
(949) 706-7000

STUART B. ESNER
Counsel of Record
HOLLY N. BOYER
ESNER, CHANG & ELLIS
500 North Brand Boulevard
Suite 2210
Glendale, California 91203
(818) 956-3100

Attorneys for Petitioner Edward H. Arnold

COCKLE LAW BRIEF PRINTING CO (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

Whether a "violation" sufficient to trigger the statute of repose for commencing a securities fraud action is subject to a wooden, inflexible standard so that the violation *always* occurs when the parties have committed themselves to complete the purchase or sale transaction (such as found by the Second Circuit here), or the violation *always* occurs upon the first misrepresentation (such as found by other Circuits), or whether courts should analyze the particular nature of the claim involved to determine on a case-by-case basis when the "violation" takes place.

RULE 14.1(b) STATEMENT

The petitioner, who was the plaintiff-appellant below, is Edward H. Arnold.

The respondents, who were the defendants-appellees below, are KPMG LLP and Sidley Austin Brown & Wood LLP.

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The opinion of the Court of Appeals for the Second Circuit was not reported. App. 1-7. The opinion of the District Court is reported at 543 F.Supp.2d 230 and reprinted in the Appendix. App. 8-25.

JURISDICTION

The judgment of the Court of Appeals was entered on June 1, 2009. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

The question presented by this petition involves 28 U.S.C. § 1658(b) entitled "Time Limitations on the commencement of civil actions arising under Acts of Congress," which provides in relevant part:

> (b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of –

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

INTRODUCTION

The critical question presented in this petition is at what point the statute of repose begins to run in a federal securities fraud action. Under *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991) and 28 U.S.C. § 1658(b), the statute begins to run upon a "violation." However, since *Lampf,* Courts have construed "violation" in inconsistent and irreconcilable ways, yielding conflicting and unpredictable results. There is simply no consensus as to when a violation occurs. The inconsistent interpretations of when a violation occurs frustrate not only the triggering event for the statute of repose but also the application of the discovery rule in such actions. This Court recently granted *certiorari* in *Merck & Co., Inc. v. Reynolds*, 2009 U.S. Lexis 3913 (U.S., May 26, 2009), decision below 543 F.3d 150 (3rd Cir. 2008), to determine when an investor is on "inquiry notice" of its claim pursuant to *Lampf* and Section 1658(b). This Court's analysis in *Merck* will necessarily relate to the predicate question of what constitutes a "violation" as it is not until there has been a "violation" that the plaintiff can then be on "inquiry notice" of the facts constituting that violation. Thus, so that this Court may fully explore when the discovery rule *and* statute of repose begins

to run in federal securities fraud cases, *certiorari* should also be granted in this matter.

Alternatively, should this Court not be inclined to grant *certiorari* review, Plaintiff requests that the Court issue a GVR order (grant certiorari, vacate the judgment below, and remand the case) following this Court's decision in *Merck*. As the issue in *Merck* concerns the term "violation" as used by this Court in *Lampf* and Section 1658(b), this Court's decision in *Merck* may affect how "violation" is defined for purposes of triggering the statute of repose, an issue at the center of this case. *See Lawrence v. Chater*, 516 U.S. 163 (1996).

At the heart of this matter is how the term "violation" in 28 U.S.C. § 1658(b) should be defined for purposes of triggering the statute of repose in federal securities fraud claims. Some courts (such as the Second Circuit in this case) conclude that a violation occurs when the parties have committed themselves to complete the purchase or sale transaction and thus the statute of repose *always* begins to run at that time. Other courts conclude that the misrepresentation constitutes the violation and it is at that time the statute *always* begins to run. While some securities fraud violations may occur at the time of the security transaction, or at the time of the misrepresentation, blind adherence to any rule is improper as it is necessary to determine on a case-by-case basis just when a violation has occurred.

In this case, without considering the violation alleged, the Second Circuit held that the statute of repose in federal securities claims "starts to run on the date the parties have committed themselves to complete the purchase or sale transaction." App. 3. The Second Circuit's interpretation suggests that it is the commitment to the purchase or sale of securities that is the "violation." While the purchase or sale of securities may constitute the "violation" in some federal securities claims, it may not in others. Not all federal securities claims can be treated the same when determining when there has been a Section 10(b) and Rule 10b-5 violation.

Federal securities fraud claims differ in nature. Some securities fraud claims involve a "one-shot deal" where there is a material misrepresentation, inducing the plaintiff to purchase or sell securities which results in harm to the plaintiff. Other cases of securities fraud may involve ongoing relationships where there are continued misrepresentations upon which the plaintiff relies upon to his or her determinant. In some instances, the material misrepresentations may not even occur until after there has been a purchase or sale of securities. In light of the varied nature of federal securities fraud claims, a blanket ruling that the statute of repose always begins at the time of the purchase or sale of security, or some other arbitrarily pre-defined event, does not accurately reflect the intentions of this Court and Congress in defining the triggering event as the "violation" alleged.

The error in applying a blanket ruling as to when the statute of repose begins in federal securities fraud actions can be seen in the increasingly divided federal court decisions on this issue. While some courts focus on the date of the purchase of sale of securities, others focus on the date of the misrepresentation made. The decisions are further complicated when the facts alleged reveal that neither focus constitutes the actual Section 10(b) and Rule 10b-5 violation alleged. Courts have noted their frustration and the absence of any uniformity. There is simply no consensus among federal courts as to when the statute of repose begins in federal securities fraud claims.

In light of the uncertainty in this area of the law and the devastating effect of a period of repose, this Court should clarify the triggering event for securities fraud claims and resolve when a violation of Section 10(b) and Rule 10b-5 occurs for purposes of triggering the statute of repose.

STATEMENT

This case concerns the unscrupulous conduct of Defendants KPMG LLP ("KPMG") and Sidley, Austin, Brown & Wood LLP ("Brown & Wood") against Plaintiff Edward H. Arnold. KPMG and Brown & Wood jointly orchestrated a fraud so massive that the Department of Justice labeled the criminal case "the largest criminal case ever filed." As part of the Deferred Prosecution Agreement showing

criminal culpability, KPMG *admitted* that the tax shelter schemes were bogus and fraudulent.

A. The Fraudulent Tax Scheme Orchestrated by KPMG and Brown & Wood.[1]

In the 1990s and continuing through 2000, KPMG created the Foreign Leveraged Investment Program ("FLIP"), Offshore Portfolio Investment Strategy ("OPIS") and Bond-Linked Issue Premium Structure ("BLIPS") investment schemes (collectively referred to herein as the "tax shelters"), which were tax avoidance products that KPMG mass marketed to its clients in order to generate millions of dollars in fees. JA95.[2] In marketing the tax shelters to its clients, KPMG represented that it would save clients substantial amounts in federal income tax liability, and that the IRS would "more likely than not" allow the tax benefits generated by the tax shelter. JA95;101. KPMG was successful in inducing Plaintiff to participate in this elaborate fraudulent scheme. JA95. Both orally and in writing, KPMG assured Plaintiff of the legality of the tax shelters and that there was little or no risk that the IRS would disallow the promised benefits. JA101.

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[1] The following alleged facts are derived from the operative complaint in this matter, as well as public documents of which this Court may properly take judicial notice. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

[2] "JA" refers to the Joint Appendix that was filed by the parties in the Second Circuit.

KPMG worked together with Brown & Wood to design and promote the tax shelters sold by KPMG. JA95;101-102. In promoting the tax investment schemes, KPMG advised Plaintiff that Brown & Wood had a thorough understanding of the tax shelter transactions, which would allow it to give an intelligent, independent opinion on the tax shelter's legality. JA101. To effectuate the tax shelters, Brown & Wood provided Plaintiff (and hundreds of other victims) a false opinion letter stating that it was "more likely than not" that a deduction taken for the losses generated by the tax shelters would be upheld if challenged by the IRS. JA95-96.

The "independent" opinion of Brown & Wood attesting to the legality of the tax shelters was a sham. JA101-102. KPMG paid Brown & Wood a fee of at least $50,000 for every supposed "independent" letter that it provided to a tax shelter participant. JA102;114. Defendants created these false form opinion letters to induce clients to claim the phony tax shelter losses on tax returns and evade taxes. JA405.

B. KPMG and Brown & Wood Defraud Edward Arnold.

In direct reliance on Defendants' representations concerning the legitimacy of the tax shelter and its tax consequences, Plaintiff Edward Arnold engaged in a number of securities transactions. JA110. On September 30, 1997, Plaintiff purchased a warrant

from Arrowhead Capital, Inc. ("Foreign Corporation"), at a cost of $1,050,000, entitling Plaintiff to acquire a specified number of newly issued shares of Foreign Corporation. JA110. Also on September 30, 1997, Plaintiff purchased 634 shares of stock of Union Bank of Switzerland ("Foreign Bank") for CHF 1,716.7 per share, or approximately $750,000. JA110. On October 3, 1997, Foreign Corporation purchased 12,750 Foreign Bank shares for CHF 1,718.0 per share, or approximately $15,000,000. JA110. On November 21, 1997, Foreign Bank exercised all its call options and purchased 12,750 of its shares held by Foreign Corporation. JA110. Foreign Bank purchased such shares at the option's strike price of CHF 1,632.10 per share. JA110.

On the same day that Foreign Bank redeemed the shares held by Foreign Corporation and simultaneously with such redemption, and at the urging of Defendants and in reliance on Defendants' representations that the tax shelter sold to Plaintiff was legitimate, Plaintiff purchased 12,750 over the counter call options on Foreign Bank shares ("Investor Options"). JA111. On December 10, 1997, Plaintiff sold the Investor Options to Foreign Bank and on December 31, 1997, Plaintiff sold 570 Foreign Bank shares. JA111.

Each of the above securities transactions were carried out at the express direction of Defendants. JA99;111-116. In connection with the securities transactions described above and the purchase of the tax shelter, Defendants represented to Plaintiff that

(1) it was "more likely than not" that a tax deduction for the securities transactions would be upheld if challenged by the IRS; (2) the tax shelter and the securities transactions were "more likely than not" to survive scrutiny by the IRS; and (3) the tax shelter sold to Plaintiff did not need to be registered as a tax shelter with the IRS. JA99;111-116.

However, Defendants knew but did not disclose to Plaintiff that the IRS would likely succeed in challenging any deductions taken for losses generated by the fraudulent tax shelters. JA112-113. During the development of tax products, Defendants were aware of the various illegalities with the tax scheme, but nevertheless approved the schemes. JA99;405. When KPMG's Washington National Tax Office approved the BLIPS documentation in August 1999, KPMG officer Randy Bickham, who helped devise BLIPS, wrote to a partner of Brown & Wood, "We have received our 'get out of jail free card' from [Washington National Tax]." JA405.

Plaintiff, in reliance on the misrepresentations of Defendants, was induced to and did invest in the tax shelter and securities transactions necessary to effectuate the tax shelter, claimed a tax deduction for the losses generated by the transactions on his federal and state tax returns, conducted his business in such a way to realize taxable income which would be offset by the losses generated by the shelter and the transactions, and did not adopt other available strategies which would have deferred or minimized tax liability during that time. JA112-113. In not

reporting the tax shelter on his tax returns and claiming a tax deduction for the losses generated by the securities transactions, Plaintiff trusted his fiduciaries, who held themselves out as experts in the field with superior knowledge of the tax shelter scheme. JA115-116.

Thus, Plaintiff's reliance on Defendants' misrepresentations in the initial purchase and sale of the securities constituted a mere step in the overall fraudulent tax shelter scheme. Until August 2005, KPMG and Brown & Wood made misrepresentations to Plaintiff and others with regards to the validity of the subject tax shelters. JA97-98;115-116. "Prior to August 2005, KPMG and Sidley *repeatedly assured* Plaintiff that the tax shelters and related securities transactions were legitimate and legal, and that KPMG and Sidley had done nothing wrong." JA97;115-116. Plaintiff relied on Defendants' specific misrepresentations as to the tax consequences of the securities transactions when he claimed a tax deduction for the losses generated by the transactions and failed to report the abusive tax shelter in his tax returns. Thereafter Plaintiff continued to rely on the continuous misrepresentations of Defendants and did not amend his tax returns to avoid liability for the illegal tax shelter. Such reliance was explicitly what Defendants intended when they presented the tax scheme as a tax avoidance product.

Up and until the August 2005 Deferred Prosecution Agreement, Defendants undertook considerable efforts to conceal information and documents relating

to the tax shelters from Plaintiff and government investigators. JA97-98;103;111-112. It was not until the criminal investigation based on the tax shelters came to a head in August 2005 that KPMG and Brown & Wood finally began to come clean about their web of deceit. JA96-98. As a result of the investigations and audits of the IRS, the tax shelter sold to Plaintiff and others have been disallowed. JA104. Plaintiff and other KPMG clients who purchased the tax shelters have been assessed with millions of dollars in additional tax liability, penalties and interest. JA104.

C. Plaintiff Arnold Files Suit.

The original complaint in this matter sought relief on behalf of Plaintiff and all others similarly situated against KPMG and Brown & Wood for breach of contract, breach of fiduciary duty, accounting malpractice, legal malpractice and unjust enrichment. JA11-31. The original complaint was filed on August 19, 2005. Less than one month after the class action complaint was filed and before Defendants filed any responsive pleading, the first amended class action complaint was filed. JA32-54. The first amended complaint, filed on September 14, 2005, contained the same state law claims and differed only slightly from the original complaint. JA32-54. On December 23, 2005, the action was stayed in light of a related class action proceeding pending in a district court in New Jersey. JA5.

On February 6, 2007, Plaintiff's current counsel sent a letter to the court noting that he had been retained by Plaintiff and advising the court of the recent developments in the class action suit in New Jersey. JA72-73. Plaintiff's counsel explained that Plaintiff had opted out of the class action lawsuit and that Plaintiff's counsel had met and conferred with counsel and all parties agreed that the stay should be lifted and Plaintiff should be permitted to amend his complaint so as to make clear that Plaintiff was pursuing his claims individually (as opposed to the class action allegations in the previous complaints). JA72-73. The court lifted the stay and permitted Plaintiff to amend his complaint. JA5. Plaintiff's second amended complaint, filed March 27, 2007, omitted the class action allegations.

Shortly thereafter, and before Defendants filed a responsive pleading to the second amended complaint, Plaintiff's counsel became aware of additional causes of action which were not previously pled in the original class action complaints or the second amended complaint and requested leave to amend to include such claims. JA93. The court granted such relief and Plaintiff filed his third amended complaint, alleging for the first time federal securities violations. JA95-117. Plaintiff's third amended complaint was filed on June 12, 2007.

D. The District Court Dismisses Plaintiff's Claims as Time Barred.

Defendants moved to dismiss Plaintiff's federal securities fraud claims arguing in part that they were barred by the three year statute of repose. JA8. The District Court granted the motion to dismiss finding that Plaintiff's claims for federal securities fraud pursuant to Section 10(b) and Rule 10b-5 were time barred. JA468-472;498.

The Court reasoned:

> *Lampf* teaches us that a claim under Section 10(b) and Rule 10(b)(5) [sic] must be brought either within one year of the discovery of the facts constituting the fraud, or within three years of the purchase of the security. That's the *Lampf* decision at Page 363 and 364.

JA470. The Court held that because Plaintiff alleged a series of securities transactions commencing in September 1997 and concluding on December 31, 1997, "the triggering event occurred no later than December 31, 1997, so the statute of repose ran on December 31, 2000." JA469-472.[3]

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[3] At the time of Plaintiff's securities transactions, claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 had to be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, supra*, 501 U.S. at 364. As part of Sarbanes-Oxley, enacted on July 30, 2002, Congress amended the 1 and 3 year limitations scheme for private securities fraud actions, previously established by the Supreme

(Continued on following page)

The Court likewise granted the motion to dismiss Plaintiff's state law malpractice claims. Even though Plaintiff represented to the Court that he could amend his complaint to allege facts which would directly overcome the Court's perceived deficiencies in the operative complaint concerning the malpractice claims, and in spite of the fact that Defendants' motions to dismiss were the first time that their statute of limitations defense had been raised and considered by the Court, the Court refused Plaintiff's request for leave to amend. *See* JA487-489;495-497;509-510. In fact, the District Court refused to even allow Plaintiff's counsel the opportunity to detail the further allegations that could be pled against KPMG, repeatedly cutting counsel off by stating "forget KPMG." *See* JA486-488.

In response to Plaintiff counsel's comment at the hearing that leave should be granted because, among other reasons, this was the first time the Plaintiff was provided the benefit of the Court's comments as to the sufficiency of the allegations, the Court pronounced "Pleadings, however, are not essays to be graded by the District Court with allowances for

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Court in *Lampf*. The Sarbanes-Oxley Act of 2002 extended the statute of repose to two years after discovery of the facts constituting the violation or five years after the violation. *See* 28 U.S.C. § 1658(b). The extended time periods in Section 1658(b) do not apply retroactively to revive causes of action the court concludes are time barred before July 30, 2002. *See In re Enter. Mortg. Acceptance Co., LLC Sec. Litig.*, 391 F.3d 401, 411 (2d Cir. 2004).

editing and revision." JA509. Included in its harsh remarks, the District Court further held "[t]here is a reason for the statute of limitations – it is repose." JA510. "[I]t is time to bring this matter to a close." JA510.[4]

E. The Second Circuit Affirms Dismissal of the Federal Securities Fraud Claims.

The Second Circuit affirmed the District Court's order dismissing the federal securities fraud claims as time barred in its Summary Order. App. 3-4. According to the Second Circuit, "[t]he three-year statute of repose in federal securities law claims 'starts to run on the date the parties have committed themselves to complete the purchase or sale transaction.' *Grondahl v. Merritt & Harris, Inc.*, 964 F.2d 1290, 1294 (2d Cir. 1992)." App. 3. The Court reasoned that because the last of the securities transactions alleged by Plaintiff occurred on December 31, 1997, Plaintiff's lawsuit filed on August 19, 2005 was time barred. App. 3-4.

The Second Circuit rejected Plaintiff's contention that the triggering event for the statute of repose was the date of the last fraudulent misrepresentation.

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[4] The Court's further supposed basis for refusing to permit Plaintiff leave to amend, because he had opted-out of the related class action, was also wholly inappropriate. A495-496. A plaintiff's decision to opt-out of a class action should in no way affect his right to amend his complaint in an individual action.

"Plaintiff's contention that the period of repose begins to run at the time of the last alleged misrepresentation (even when made after the final purchase or sale of the securities) ignores the applicable limitations period, and thus, is devoid of merit." App. 4.

REASONS FOR GRANTING THE WRIT

This Court should grant *certiorari* to clarify the standard for determining when the statute of repose begins in federal securities fraud actions. Review by this Court is necessary as following *Lampf*, federal courts have failed to express a definition of when the statute of repose begins capable of uniform application. Rather than simply stating that the triggering event for the statute of repose differs depending upon the securities violation alleged, federal courts have provided their own particular findings as to when they believe the statute of repose begins in securities fraud cases. These holdings are thereafter summarily applied without regard to the securities fraud alleged. Blanket rulings providing an arbitrarily defined point in time as the triggering event for the statute of repose ignores the very term "violation" used by this Court and in Section 1658(b). The inconsistent application of the repose period results in directly contrary results depending upon which court the plaintiff happens to file in.

Just as *Lampf* was necessary to establish a uniform limitations period for federal securities fraud claims under Section 10(b) and Rule 10b-5, it is now necessary for this Court to provide a uniform definition of when a violation occurs triggering the statute of repose.

Review at this time is particularly appropriate as this Court has recently granted *certiorari* in *Merck & Co., Inc. v. Reynolds*, 2009 U.S. Lexis 3913 (U.S., May 26, 2009), decision below 543 F.3d 150 (3rd Cir. 2008). The issue in *Merck* concerns when the statute of limitations for a federal securities fraud claim begins. The petition for *certiorari* notes that while there is broad agreement among lower courts that the statute of limitations commences once an investor is on "inquiry notice" of its claim, courts are split as to what exactly it means to be on "inquiry notice." While this Court is deciding the proper meaning of "inquiry notice" in *Merck*, this Court should also explore and provide clarification as to the meaning of "violation" for purposes of triggering the statute of repose in the same statute.

It is imperative to note that Congress used the term "violation" when describing both the statute of limitations and the statute of repose. *See* 28 U.S.C. § 1658(b). Thus, this Court's analysis of the meaning of "violation" as used in 28 U.S.C. § 1658(b) is intertwined in both defining the statute of limitations and the statute of repose in federal securities fraud actions.

I. Pursuant to *Lampf* and 28 U.S.C. § 1658(b), the Triggering Event for the Statute of Repose is the "Violation" of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 Alleged.

In *Lampf*, this Court held that "Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such *violation*." *Lampf*, 501 U.S. at 364 (emphasis added). Congress codified *Lampf* by enacting 28 U.S.C. § 1658(b) which provides that a federal securities fraud action must be brought within "2 years after the discovery of the facts constituting the violation" or "5 years after such *violation*." *See* 28 U.S.C. § 1658(b) (emphasis added). Thus, this Court and Congress have expressly defined the triggering point for the statute of repose in federal securities fraud claims as the "violation" alleged.

This Court noted that to the extent "that the various 1-and-3 periods contained in the 1934 and 1933 Acts differ slightly in terminology," the governing standard for Rule 10b-5 actions came from the language of Section 9(e) of the 1934 Act (15 U.S.C. § 78i(e)), which refers to the triggering event also as the "violation." *See Lampf*, at 364 fn. 9; *cf.* 15 U.S.C. § 77m (statute of repose runs from the date of "the sale"). As such, it was this Court's intent that the "violation" trigger the statute of repose, and not some

other definitive point such as the sale of securities as defined in other federal security statutes.

Determining the point where there has been a violation of Section 10(b) and Rule 10b-5 depends upon the federal securities fraud alleged. Section 10(b) is addressed to deception "in connection with the purchase or sale of any security." *Goodman v. Epstein*, 582 F.2d 388, 410 (7th Cir. 1978). The Supreme Court has interpreted the "in connection with" requirement broadly: to be actionable, the deception need only "touch" the transaction complained of. *Id.*; *citing Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971). The words "purchase" and "sale" have similarly been broadly construed for Section 10(b) purposes. *Id.* To effectuate the broad remedial purpose of the federal security laws, they are to be construed liberally and flexibly. *See Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). "Thus, in interpreting the phrase 'in connection with the sale or purchase of any security,' which does not admit a precise definition, we must consider the facts of the particular case." *Goodman*, 582 F.2d at 411; *citing, e.g., Allico Nat. Corp. v. Amalgamated Meat Cutters*, 397 F.2d 727 (7th Cir. 1968); *A. P. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971).

The Ninth Circuit visited the issue of what constitutes a "violation" in *Johnson v. Aljian*, 490 F.3d 778, 781-783 (9th Cir. 2007). While the case did not concern how to define "violation" for purposes of triggering the statue of repose, its discussion

concerning the definition of a Section 10(b) and Rule 10b-5 violation is instructive. After considering the *Webster Dictionary* and the *Black's Law Dictionary*, the Ninth Circuit held, "[w]e believe that the term 'violates' ordinarily is understood to mean that a person has satisfied the essential elements of a proscribed act." *Id.* at 781. Citing its earlier decision in *Ambassador Hotel Co., Ltd. v. Wei-Chuan Investment*, 189 F.3d 1017 (9th Cir. 1999), the Ninth Circuit noted:

> [T]o prove *violation* of either Section 10(b) or Rule 10b-5, the private plaintiff must demonstrate that the alleged fraud occurred "in connection with the purchase or sale of a security." Once this foundational requirement has been met, the plaintiff must prove five elements: 1. Misrepresentation (or omission, where there exists some duty to disclose); 2. materiality; 3. scienter (intent to defraud or deceive); 4. reliance; and 5. causation. The plaintiff must prove both actual cause ("transaction causation") and proximate cause ("loss causation").

Id. at 782. Thus, it appears that the determination of when a "violation" occurs depends upon when the "essential elements" of a claim under Section 10(b) and Rule 10b-5 have occurred.

As such, in light of the differences between the types of securities fraud cases and the prescription that a violation of Section 10(b) cannot be strictly defined but should be based on the facts in each case,

the triggering event for the statute of repose should not be arbitrarily defined by the happening of some event. It simply cannot be said that a violation of a federal securities fraud claim *always* occurs at the time of the purchase or sale of securities.

II. Since *Lampf* and Section 1658(b), Federal Courts Have Arrived at Varying and Inconsistent Holdings as to When the Statute of Repose Begins.

As this Court and Section 1658(b) make clear, it is the alleged violation that triggers the statute of repose and not some pre-determined event. Despite such, Courts throughout the Country, and specifically the Second Circuit, have attempted to attach a defined point in time as the absolute triggering event for the accrual of the statute of repose.

(i) The Second Circuit and Other Courts Have Concluded That a Violation Occurs at the Time of the Purchase or Sale of Securities.

According to the Second Circuit, the statute of repose for federal securities fraud claims starts to run "on the date the parties have committed themselves to complete the purchase or sale transaction." App. 3. Thus, the Second Circuit has concluded that the statute of repose begins, not at the time of the alleged violation, but rather at the time of the commitment to the purchase or sale of securities. In fact, the blur

between what this Court and Section 1658(b) define as the triggering event ("violation") and what the Second Circuit has held is the triggering event (the purchase or sale of securities) is evident in the opinion in this case. In a footnote in its opinion, the Second Circuit described the Sarbanes-Oxley Act of 2002 (28 U.S.C. § 1658(b)) as extending "the statute of repose to two years after discovery of the alleged fraud and five years *from the date of the securities transaction*." App. 3. As noted above, Section 1658(b) *does not* define the triggering event as the "date of the securities transaction." *See* 16 U.S.C. § 1658(b). Rather, Section 1658(b) expressly states that the statute of repose shall begin "5 years after such *violation*." *Id.* The Second Circuit clearly does not appreciate this distinction.

Unfortunately, the Second Circuit is not alone in its misconception of how Congress has defined the triggering event for the statute of repose. *See, e.g., Marks v. CDW Computer Centers, Inc.*, 901 F.Supp. 1302, 1314 (N.D. Ill. 1995) [for Section 10(b) and Rule 10b-5 claims, "plaintiff has . . . no more than three years from *date of the transaction*, which gave rise to the cause of action."]; *Getty v. Harmon*, 53 F.Supp.2d 1053 (W.D. Wash. 1999) [the statute "bars recovery on *investments made* more than three years before the filing of the action."]

Here, the Second Circuit's labeling of the triggering event for the statute of repose as the date of the securities transactions, rather than the date of the alleged violation, proved fatal to Plaintiff's

claims. The Court held that because the last of the securities transactions occurred on December 31, 1997, Plaintiff's claims were time barred as of December 31, 2000. App. 4. The Court relied upon *Grondahl v. Merritt & Harris, Inc.*, 964 F.2d 1290 (2d Cir. 1992), which in turn cited *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876 (2d Cir. 1972), to support of its holding. While the ultimate holdings in *Grondahl* and *Radiation Dynamics* are consistent with Plaintiff's interpretation of "violation" for purposes of triggering the period of repose, the language in those decisions stating that the blanket rule in federal securities fraud actions is that the period of respose begins on the date of purchase or sale is inaccurate. It is this language that perpetuates the underlying misconception that the triggering event for the statute of repose can be absolutely defined.

Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2d Cir. 1972), the case relied upon by *Grondahl*, was decided almost twenty years before *Lampf*'s holding that the statute of repose begins at the time of the alleged "violation." *Radiation Dynamics* involved whether the applicable statute of limitations began to run when the parties committed themselves to complete the purchase or sale of securities, or whether the statute was triggered at the purchase or sale. *Radiation Dynamics*, 464 F.2d 890-891. There the plaintiff corporation brought an action against the defendant investors alleging that they violated Section 10(b) and Rule 10b-5 when they purchased from the plaintiff 6,500 shares of stock in a company

without disclosing to the plaintiff allegedly material inside information which was known to the defendants (information that the company had general plans to seek an upcoming merger). The Second Circuit held that the violation of 10(b) and 10b-5 occurred when the parties committed to the sale and thus it was at that point the statute of repose began. *Id.* at 891.

The Second Circuit rejected the plaintiff's contention that the proper date was the date the securities were transferred or paid for, irrespective of when the parties are bound by contract to purchase or sell the securities. *Id.* at 891. The Court held that such an argument "disregards the clear and frequently stated policy of interpreting Rule 10b-5 to avoid reliance on formalism" and that "the essential purpose of Rule 10b-5, as we have stated time and again, is to prevent corporate insiders and their tippees from taking unfair advantage of the uninformed outsiders." *Id.* at 891. The Court cautioned, "[i]t was not intended to provide an escape hatch through which disgruntled buyers or sellers could avoid transactions to which they had become committed, but which had not been fully consummated by the formal exchange of the money or the securities agreed upon to be exchanged." *Id.* at 891. Accordingly, the Court held "that the time that an insider places an order, rather than the time of its ultimate execution, be determinative for Rule 10b-5 purposes." *Id.* at 891.

Thus, in *Radiation Dynamics*, the Second Circuit determined the triggering event for the insider trading claim as the date the parties committed to the purchase or sale of securities. The Court's decision in no way states that a federal securities fraud claim can *never* be past the point of the purchase or sale of securities, but rather the case focuses on the facts before it in determining the appropriate triggering date.

In fact, the Seventh Circuit has expressly held that notwithstanding *Radiation Dynamics*, a Section 10(b) and Rule 10b-5 securities fraud violation can occur *after* the purchase or sale of security. *See Goodman v. Epstein*, 582 F.2d 388, 414 (7th Cir. 1978). *Goodman* involved a limited partnership land development scheme gone awry. The plaintiffs alleged violations of the Securities Exchange Act, Section 10(b) and Rule 10b-5, as well as common-law fraud and misrepresentations. As to the federal securities claims, the plaintiff argued on appeal that the trial court improperly instructed the jury that there could only be one "purchase" of security and thus a single violation of a Section 10(b) and Rule 10b-5 occurring when the parties "committed" to the limited partnership venture. The plaintiff argued and the Seventh Circuit agreed that because subsequent decisions and even capital contributions were made after committing to the limited partnership, any material misrepresentations or omissions at that time were nonetheless "in connection with the purchase or sale"

of security as required by Section 10(b) and Rule 10b-5. *Goodman*, at 398 & 414.

The Seventh Circuit explained that while *Radiation Dynamics* involved an alleged securities fraud violation that was a "one shot deal," not all securities fraud cases are the same. In *Radiation Dynamics*, "[n]o continuing relationship was contemplated. All that was left undone was the ministerial exchange of the money for the stock." *Id.* at 412.

> In the case now before us, the circumstances are substantially different from those faced by the *Radiation Dynamics* court. What we have here is Not [sic] a one-shot deal. . . . The parties clearly envisioned an ongoing relationship under the Agreement with the management making all of the decisions affecting the basic value of the enterprise and its chances of progressing toward its advertised goal.

Id. Thus, the Seventh Circuit noted that the further misrepresentations and omissions made *after* the entering into of the limited partnership were nonetheless "in connection with the purchase or sale of security" and thus violations of Section 10(b) and Rule 10b-5. *Id.* at 413-414.

In rejecting the defendant's reliance on *Radiation Dynamics*, the Seventh Circuit noted that while at first blush the language in *Radiation Dynamics* stating that a securities violation occurs when the parties committed to the limited partnership venture appears persuasive, "[a] closer inspection, however, indicates

that the facts before this Court, and the underlying equities involved, are sufficiently different that a '*wooden adherence*' to the general proposition stated in the quoted language would not serve to further 'the goal of fundamental fairness in the securities marketplace.'" *Id.* at 413 (emphasis added).

Goodman's insight as to the different types of securities fraud claims under Section 10(b) and Rule 10b-5 is instructive in demonstrating why the statute of repose cannot begin at a pre-determined triggering event for all securities fraud claims.

(ii) Other Jurisdictions Have Concluded That a Violation Occurs at the Time of the Misrepresentation.

Considering the issue of when a violation occurs, some federal courts have held that when the defendant makes the material misrepresentation constitutes the violation triggering the statute of repose. *See In re Exxon Corp. Securities Litigation*, 500 F.3d 189 (3rd Cir. 2007); *Bovee v. Coopers & Lybrand*, 216 F.R.D. 596, 604 (S.D. Ohio 2003).

In *In re Exxon Corp.*, the plaintiff shareholders alleged that a misrepresentation by Exxon made in the course of merger negotiations caused them to receive fewer shares in the combined corporation than they otherwise were entitled. The Third Circuit considered whether the plaintiffs were barred from bringing the action pursuant to the statute of repose

for federal securities fraud claims. The Court presented the issue as: "when did § 9(e)'s and § 1658(b)(2)'s statute of repose begin to run – at the time of Exxon's alleged misrepresentation (the March 1999 proxy statement) or at the time its merger with Mobil was consummated (late November 1999)." *Id.* at 199. The Court held that the statute of repose began at the time of the misrepresentation, not the date the merger was consummated. *Id.* at 201.

The Third Circuit focused on Congress' choice of the word "violation" as opposed to "accrual" and found that the specific acts targeted by a Section 10(b) cause of action are fraudulent statements themselves and "therefore [it] is more consonant with the tradiional understanding of how a statute of repose funcons for the repose periods of § 9(e) and § 1658(b)(2) to begin from the date of Exxon's alleged misrepresenation." *Id.* at 200. Thus, the Third Circuit concluded that the fraudulent misrepresentation itself is the specific event triggering the period of repose. *Id.*

To support its holding, the Third Circuit argued that dictum from this Court's opinion in *Lampf* supported the triggering of the statute of repose upon the alleged misrepresentation.

> The Supreme Court has also weighed in, although only in a dictum. The concluding line of *Lampf*, which disposes of the case, reads: "As there is no dispute that the earliest of plaintiff-respondents' complaints was filed more than three years after petitioner's alleged misrepresentations, plaintiff-respondents'

> claims were untimely." 501 U.S. at 364, 111 S.Ct. 2773 (emphasis added). As the misrepresentations in *Lampf* occurred at about the same time as the exchange of securities, whether the date to begin running the statute of repose is the date of the misrepresentation was not necessary to the Court's decision. Nonetheless its focus was on the alleged misrepresentation, not the exchange of securities.

Id. at 200.

However, the Third Circuit's reliance on the dictum in *Lampf* is misguided. While this Court may have noted in dictum that the complaint was "filed more than three years after petitioner's alleged misrepresentations," the facts do not demonstrate that it was the date of the alleged misrepresentations (the dates of which are not included in the facts in *Lampf*) that actually triggered the statute of repose. According to the facts, the complaint was filed more than three years from the essential elements of a Section 10(b) and Rule 10b-5 violation (material misrepresentations had been made in connection with the purchase or sale of securities and were relied upon by the plaintiffs to their detriment).

However, even more problematic is *In re Exxon*'s blanket holding that the triggering event for the statute of repose in all federal securities actions. At the conclusion of its opinion, the Court held: "we hold that the repose period applicable to § 10(b) claims as set out in §§ 9(e) and 1658(b)(2) begins to run on the

date of the alleged misrepresentation." *Id.* As explained above, not all federal securities fraud claims will the violation alleged occur on the date of the misrepresentation.

(iii) In Cases Where a Series of Fraudulent Misrepresentations Are Alleged, Some Jurisdictions Have Concluded That the Statute of Repose Begins On the Date of the Last Alleged Misrepresentation.

Aptly focusing on the violation alleged, some jurisdictions have concluded that where a series of fraudulent misrepresentations have been alleged, the statute of repose begins on the date of the last material misrepresentation made. *See Plymouth County Retirement Ass'n v. Schroeder*, 576 F.Supp.2d 360, 377-378 (E.D.N.Y. 2008); *Quaak v. Dexia, S.A.*, 357 F.Supp.2d 330, 338 (D. Mass. 2005); *Winters v. Stemberg*, 529 F.Supp.2d 237, 246-247 (D. Mass. 2008); *Bordon, Inc. v. Spoor Behrins Campbell & Young, Inc.*, 778 F.Supp. 695, 699 (S.D.N.Y. 1991); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 2005 U.S. Dist. Lexis 19506, *19 (S.D.N.Y. 2005); *see also Goodman v. Epstein*, 582 F.2d 388, 414 (7th Cir. 1978).

In *Winters*, *supra*, the plaintiffs brought a shareholder derivative action on behalf of Staples, Inc. against corporate officers and directors of Staples for engaging in a scheme to "backdate" stock options in violation of corporate stock option policies. *Winters*,

529 F.Supp.2d at 242. The defendants in *Winters* argued that the plaintiffs' claim for violation of Section 10(b) began to run from the date the stock option was granted and because the stock options were granted more than five years before the plaintiffs' suit was filed, the action was barred by the statute of repose. The court rejected defendant's position on the date when the statute of repose begins, and held that "the repose period begins when the last alleged misrepresentation was made by any of the [p]articipants." *Id.*

The plaintiffs in *Winters* asserted that the defendants' actions caused Staples to make misrepresentations in a *series of financial statements*, the last of which was filed on February 28, 2006. *Id.* at 246-247. As such, the court concluded that the statute of repose did not begin to run until the last misrepresentation. *Id.* at 247. The court noted, "[t]he argument that the Plaintiffs should have filed sooner given the circumstances of this case is incredible." *Ibid.*

While this approach seems to best demonstrate the application of the term "violation" to the facts alleged in the securities fraud claim when determining when the statute of repose begins, courts have nonetheless struggled with the reasoning of the approach. *See In re Zoran Corp. Derivative Litigation*, 511 F.Supp.2d 986, 1014 (N.D. Cal. 2007) ["the statute of limitations accrues as of when the violation itself occurs, not when the last violation in a series of alleged violations occur"]; *In re Prudential Ins. Co. of*

Am. Sales Practice Litig., 975 F.Supp. 584, 605 (D.N.J. 1997) [finding that where there are a series of misrepresentations, each misrepresentation triggers its own statute of repose].

In *In re Prudential*, the district court held that the statute of repose "begins to run on the date the defendant made an affirmative misrepresentation or, in the case of an omission, upon the date a duty to disclose the withheld information arises." *Id.* at 605. The district court noted that in the event misrepresentations or omissions occur *after* an initial misrepresentation or omission, then the subsequent misrepresentations or omissions constitute separate violations with their own corresponding statute of repose. *Id.*

Thus, while some courts do correctly consider when the essential elements of the violation occurred, rather than simply looking at the date of the purchase or sale of security, there is still much confusion as to what constitutes a violation of federal securities fraud for purposes of triggering the statute of limitations.

III. The Varying Tests Lead to Directly Contrary Results.

Frustrated courts across the Country have noted that there is simply no consensus amongst federal courts as to what triggers the statute of repose in federal securities fraud claims. *See, e.g., In re Prudential Ins. Co. of America Sales Practices Litigation*,

975 F.Supp. 584, 602 (D.N.J. 1996) ["A point upon which the federal courts have not yet reached consensus is the question of which event triggers the three-year limitations period"]; *Wafra Leasing Corp. 1999-A-1 v. Prime Capital Corp.*, 192 F.Supp.2d 852, 864 (N.D. Ill. 2002) ["The Seventh Circuit has not decided, since *Lampf*, what the 'triggering event' for the statute of repose in § 10(b) claims is, but there are cases on both sides of the debate."]; *Plymouth County Retirement Ass'n v. Schroeder*, 576 F.Supp.2d 360, 378 (E.D.N.Y. 2008) ["the law in this area is somewhat unresolved;" "Other jurisdictions have arrived at varying and inconsistent results on this issue"]; *Combs v. Case*, 2007 WL 4440958 (D. Hawai'i 2007) [noting the split in authority as to the triggering event – "My own research confirms that courts are not in agreement on this issue."].

The differential treatment in applying the statute of repose by the federal courts and the resulting inconsistent holdings can be best demonstrated by considering the facts in this case. In this case, Plaintiff alleged that his reliance on Defendants' misrepresentations in the initial purchase and sale of the securities constituted a mere step in the overall fraudulent tax shelter scheme. Plaintiff relied on Defendants' specific misrepresentations as to the tax consequences of the securities transactions when he claimed a tax deduction for the losses generated by the transactions and failed to report the abusive tax shelter in his tax returns. Thereafter, Plaintiff continued to rely on the continuous misrepresentations

of Defendants and did not amend his tax returns to avoid liability for the illegal tax shelter. Such reliance was explicitly what Defendants intended when they presented the tax scheme as a tax avoidance product. Thus, unlike a securities fraud case where a material misstatement induces a plaintiff to purchase or sell securities resulting in harm to the plaintiff, here the misrepresentations concerned the tax treatment of the purchase and sale of securities. The fraud perpetrated by Defendants did not end when Plaintiff sold the securities.

Without regard for the federal securities fraud alleged in this case, the Second Circuit held that because the last of the securities transactions alleged by Plaintiff occurred on December 31, 1997, Plaintiff's claims were time barred as of December 31, 2000. App. 4. The Second Circuit held "Plaintiff's contention that the period of repose begins to run at the time of the last alleged misrepresentation (even when made after the final purchase or sale of the securities) ignores the applicable limitations period, and thus, is devoid of merit." App. 4.[5]

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[5] In this case, application of the statute of repose when Plaintiff purchased and sold the securities is further nonsensical as at that time there had been no violation of Section 10(b) and Rule 10b-5. It was not until Plaintiff relied upon Defendants' specific and continuous misrepresentations as to the tax consequences of the securities transactions when he claimed a tax deduction for the losses generated by the transactions and failed to report the abusive tax shelter in his tax returns that a violation occurred. If Plaintiff had filed his action the day after

(Continued on following page)

However, if Plaintiff were before a jurisdiction finding that in cases involving a series of fraudulent misrepresentations, the statute of repose begins on the date of the last alleged misrepresentation, the statute of repose would not have been triggered until August 2005. The complaint alleges that up until August 2005, Defendants made misrepresentations to Plaintiff and others with regards to the validity of the subject tax shelters. JA97-98;115-116. Plaintiff alleges that it was not until August 2005 that Defendants began to reveal the unlawfulness of their actions. JA97. Thus, the allegations concerning Defendants' continuous material misrepresentations constitute the violations of Section 10(b) and Rule 10b-5 that trigger the statute of repose. Under this approach, Plaintiff's complaint filed in August 2005 would not have been barred by the statute of repose.

Even in those cases finding that each material misrepresentation triggers its own statute of repose period (*see In re Prudential Ins., supra,* 975 F.Supp. at 605), Plaintiff's claim would be timely. Here, a violation of Section 10(b) and Rule 10b-5 occurred when Defendants repeatedly assured Plaintiff, after

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he purchased or sold the security, or even the day after he received the initial opinion letter from Defendants, there would be no claim for fraud. Even after Plaintiff filed his tax returns claiming a deduction for the losses generated, there would be no claim for fraud as even at that time he could have corrected the tax deduction and avoided the IRS penalties.

the sale of securities, that he did not need to report the abusive tax shelter in his tax returns.

Thus, the varying approaches applied by federal courts in determining when the statute of repose begins in securities fraud claims axiomatically leads to inconsistent, incongruent and unpredictable outcomes.

IV. Any Approach Other Than a Case-by-Case Analysis of the Securities Fraud Alleged Ignores the Term "Violation" as Used by this Court in *Lampf* and in Section 1658(b).

Adherence to a defined event unrelated to the particular securities fraud alleged ignores this Court and Congress' prescription that the statute of repose begin at the time of the "violation" alleged. The Second Circuit's holding that the statute of repose begins on the date the parties committed to the purchase or sale of securities, no matter the type of securities fraud alleged, is misplaced and results in the premature foreclosure of claims by victims of security fraud. The better approach is to consider each case, on a case-by-case basis, to determine when the alleged violation occurred.

While not setting forth a definition capable of uniform application among the courts, the Ninth Circuit has noted in its discussions of Section 10(b) and Rule 10b-5 claims that the statute of repose begins to run "when a person commits the act that

gives rise to liability" under Section 10(b) and Rule 10b-5. *Asdar Group v. Pillsbury, Madison and Sutro*, 99 F.3d 289, 294-295 (9th Cir. 1996).

In *Asdar*, the issue before the Ninth Circuit was when a cause of action for contribution under Rule 10b-5 accrues. Considering the elements of a cause of action for contribution, the Ninth Circuit concluded that "a defendant's right to contribution in a 10b-5 action does not arise until a defendant has paid more than her share of the judgment." *Id.* at 295. Thus, the Court held that the statute of limitation or repose does not begin until the defendant satisfies the judgment. *Id.* at 296. The Ninth Circuit's approach is congruent with Petitioner's position that the focus must be on the violation alleged – not an arbitrarily defined point in time.

V. This Case Presents an Issue of National Importance.

It is without question that the fair and effective operation of federal securities laws is of critical national importance. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006) ["The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated."]. In *Lampf*, this Court stressed the need for uniform application of the statute of limitations in federal securities fraud claims. While *Lampf*, and soon after Congress, prescribed the time periods for the statute

of repose in federal securities fraud claims, there has been no consensus among federal courts as to what triggers the statute of repose. While Section 1658(b) describes the triggering event as the "violation" of Section 10(b) and Rule 10b-5 alleged, the courts are split as to how to define "violation." Further, federal courts across the country erroneously declare that a pre-determined event, such as the date of the purchase or sale of security or the date of the alleged misrepresentation, triggers the statute of repose in all cases. Such precedence perpetuates misapplications of the statute of repose, focusing not on the violation alleged but the timing of an arbitrary event.

This Court should grant review to set a national standard capable of uniform application as to when the statute of repose begins in security fraud cases. As this Court will already be reviewing the decision in *Merck*, concerning the same federal statute, this Court should too consider the starting point for the statute of repose.

IV. In the Alternative, it is Requested that this Court Issue a GVR Order When the Decision in *Merck* Has Been Decided.

In the event this Court declines to review the critical issues concerning when the statute of repose begins, it is requested that in light of this Court's review in *Merck*, the instant matter be held until a GVR order can be issued. The decision in the instant matter was predicated on the Second Circuit's

interpretation of the term "violation" as used by this Court in *Lampf* and in Section 1658(b). In reviewing *Merck*, this Court may necessarily visit the issue of how "violation" is to be defined for purposes of triggering inquiry notice. If so, the Court's determination may touch on whether the Second Circuit's definition of the term was accurate in this matter.

CONCLUSION

For the foregoing reasons, the petition for writ of *certiorari* should be granted.

Respectfully submitted,

MICHAEL J. AVENATTI
EAGAN, O'MALLEY & AVENATTI LLP
450 Newport Center Drive
Second Floor
Newport Beach, California 92660
(949) 706-7000

STUART B. ESNER
Counsel of Record
HOLLY N. BOYER
ESNER, CHANG & ELLIS
500 North Brand Boulevard
Suite 2210
Glendale, California 91203
(818) 956-3100

Attorneys for Petitioner Edward H. Arnold

2009 WL 1514589

United States Court of Appeals,
Second Circuit.
Edward H. ARNOLD, Plaintiff-Appellant,
v.
KPMG LLP, and Sidley Austin Brown & Wood LLP,
Defendants-Appellees.
No. 08-2040-cv.

June 1, 2009.

Michael J. Avenatti, Eagan O'Malley & Avenatti, LLP, Newport Beach, CA, for Appellant.

Robert J. Kheel, Willkie Farr & Gallagher, LLP (Kevin B. Clark and Rita D. Mitchell, on the brief), New York, NY, for Appellee KPMG.

Richard E. Drooyan, Munger, Tolles & Olson LLP, Los Angeles, CA and Covington & Burling, LLP (Andrew A. Ruffino, Philip A. Irwin, and Jason P. Criss, on the brief), New York, NY, for Appellee Sidley Austin.

Present JOHN M. WALKER, JR., RICHARD C. WESLEY and J. CLIFFORD WALLACE,* Circuit Judges.

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* The Honorable J. Clifford Wallace, United States Court of Appeals for the Ninth Circuit, sitting by designation.

SUMMARY ORDER

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the district court be **AFFIRMED**.

Plaintiff-Appellant Edward H. Arnold appeals from a judgment of the United States District Court for the Southern District of New York (Crotty, *J.*) dismissing his third amended complaint. In August 2005, Plaintiff commenced the instant action against Defendant-Appellees KPMG LLP ("KPMG") and Sidley Austin Brown & Wood LLP ("Brown & Wood") for federal securities fraud pursuant to Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5, and for several New York law causes of action, the gravamen of which was professional malpractice. The district court granted Defendants' motion to dismiss Plaintiff's amended complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure on statute of limitations grounds. We assume the parties' familiarity with the underlying facts and the procedural history of the case, as well as the issues on appeal. *See Arnold v. KPMG LLP,* 543 F.Supp.2d 230, 231-34 (S.D.N.Y.2008).

"We review de novo a district court's dismissal of a complaint pursuant to Rule 12(b)(6), accepting all factual allegations in the complaint and drawing all reasonable inferences in the plaintiff's favor." *Ruotolo v. City of New York,* 514 F.3d 184, 188 (2d Cir.2008) (internal quotation marks and citation omitted). A complaint must plead "enough facts to state a claim

to relief that is plausible on its face" to survive a motion to dismiss. *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007).

Federal Securities Law Claim

At the time of Plaintiff's securities transactions, claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 had to be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 364 (1991); *see also In re Lawrence,* 293 F.3d 615, 620-21 (2d Cir.2002).[1] The three-year statute of repose in federal securities law claims "starts to run on the date the parties have committed themselves to complete the purchase or sale transaction." *Grondahl v. Merritt & Harris, Inc.,* 964 F.2d 1290, 1294 (2d Cir.1992) (emphasis omitted).

Here, Plaintiff's claim is based on a series of securities transactions he executed beginning in September 1997 and ending in December 1997, with the last of these transactions occurring on December 31, 1997. Plaintiff did not commence this suit until

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[1] The Sarbanes-Oxley Act of 2002 extended the statute of repose to two years after discovery of the alleged fraud and five years from the date of the securities transaction at issue. *See* 28 U.S.C. § 1658(b). But these new periods do not apply retroactively to revive causes of action time-barred before July 30, 2002. *See In re Enter. Mortg. Acceptance Co., LLC Sec. Litig.,* 391 F.3d 401, 411 (2d Cir.2004).

August 19, 2005. Accordingly, the district court correctly concluded that Plaintiff's federal securities claims were time-barred as of December 31, 2000, almost five years before the commencement of this action. Plaintiff's contention that the period of repose begins to run at the time of the last alleged misrepresentation (even when made after the final purchase or sale of the securities) ignores the applicable limitations period, and thus, is devoid of merit.

State Law Claims

As the district court concluded (and Plaintiff conceded), his various state law claims against KPMG and Brown & Wood merged into a single claim for professional malpractice against both Defendants. Under New York law, an action for professional malpractice, either legal or accounting, must be commenced within three years from the date of accrual. *See* N.Y. C.P.L.R. § 214(6). "A claim accrues when the malpractice is committed, not when the client discovers it." *Williamson v. PricewaterhouseCoopers LLP,* 9 N.Y.3d 1, 7-8 (2007); *see also Glamm v. Allen,* 57 N.Y.2d 87, 93 (1982). An accounting malpractice claim "accrues upon the client's receipt of the accountant's work product since this is the point that a client reasonably relies on the accountant's skill and advice and, as a consequence of such reliance, can become liable for tax deficiencies." *Ackerman v. Price Waterhouse,* 84 N.Y.2d 535, 541 (1994). At this time, "all the facts necessary to the cause of action have occurred and an injured party can obtain relief in court." *Id.*

To sustain a claim for legal malpractice in New York, a plaintiff must demonstrate that the "attorney failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession which results in actual damages to a plaintiff and that the plaintiff would have succeeded on the merits of the underlying action 'but for' the attorney's negligence." *AmBase Corp. v. Davis Polk & Wardwell,* 8 N.Y.3d 428, 434 (2007) (internal citation omitted). Such a claim accrues "when all the facts necessary to the cause of action have occurred and an injured party can obtain relief in court." *McCoy v. Feinman,* 99 N.Y.2d 295, 301 (2002) (internal quotation marks and citation omitted). Generally, "this accrual time is measured from the day an actionable injury occurs, even if the aggrieved party is then ignorant of the wrong or injury." *Id.* (internal quotation marks and citation omitted). It is well-settled that the relevant inquiry is "when the malpractice was committed, not when the client discovered it." *Id.* (internal quotation marks and citation omitted).

We agree with the district court that the three-year statute of limitations period began to run on the accounting malpractice claim against KPMG no later than May 13, 1998, the date when KPMG issued its formal opinion letter to Plaintiff. Thus, Plaintiff's malpractice claim was time-barred as of May 13, 2001. This rule applies with equal force to the legal malpractice claim asserted against Brown & Wood. Brown & Wood issued its legal opinion letter (which contained the allegedly incorrect legal advice upon

which Plaintiff's claims are based), on August 28, 1998; thus, the claims asserted against it were similarly time-barred three years from that date. Moreover, as set forth in the well-reasoned opinion of the district court, Plaintiff cannot avoid the statute of limitations bar by claiming that the limitations period was tolled because of the continuous representation doctrine or fraudulent concealment. *See Arnold,* 543 F.Supp.2d at 236-37.

Request to Replead the Complaint

Under the Federal Rules of Civil Procedure, "[a] party may amend its pleading once as a matter of course . . . before being served with a responsive pleading." Fed.R.Civ.P. 15(a)(1). Otherwise, a party may amend its pleading by leave of the court which should be "freely give[n] . . . [when] justice so requires." Fed.R.Civ.P. 15(a)(2). "A district court has broad discretion to decide whether to grant leave to amend, a decision that we review for an abuse of discretion." *Joblove v. Barr Labs. Inc.* (*In re Tamoxifen Citrate Antitrust Litig.*), 429 F.3d 370, 404 (2d Cir.2005). "[W]here the plaintiff is unable to demonstrate that he would be able to amend his complaint in a manner which would survive dismissal, opportunity to replead is rightfully denied." *Hayden v. County of Nassau,* 180 F.3d 42, 53 (2d Cir.1999). Although leave to amend should be liberally granted, it may properly be denied for "undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously

allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc." *Ruotolo,* 514 F.3d at 191 (quoting *Foman v. Davis,* 371 U.S. 178, 182 (1962)).

We conclude that the district court acted well within its discretion in denying Plaintiff leave to amend his complaint. Plaintiff failed to identify those facts that would save his complaint, should he be granted leave to amend, with sufficient specificity. Although Plaintiff asserts he brought certain facts to the district court's attention at oral argument on the motion to dismiss, a review of the transcript of that hearing reveals that Plaintiff proffered only vague and general allegations of "communications" and "conversations" between Plaintiff and Defendants. The district court did not abuse its discretion in denying Plaintiff leave to amend under these circumstances. *See Porat v. Lincoln Towers Cmty. Ass'n,* 464 F.3d 274, 276 (2d Cir.2006).

Accordingly, for the reasons set forth above, the judgment of the district court is hereby

AFFIRMED.

543 F.Supp.2d 230

United States District Court,
S.D. New York.
Edward H. ARNOLD, Plaintiff,
v.
KPMG LLP, and Sidley Austin Brown & Wood LLP, Defendants.
No. 05 Civ. 7349(PAC).

March 28, 2008.

Alan Wasserman, Wilentz, Goldman & Spitzer, P.A., Woodbridge, NJ, Dimitri L. Karapelou, Ciardi & Ciardi, P.C., Philadelphia, PA, Michael J. Avenatti, Eagan O'Malley & Avenatti, LLP, Newport Beach, CA, for Plaintiff.

Robert J. Kheel, Willkie Farr & Gallagher LLP, New York City, Constantina Aprilakis, Willkie Farr & Gallagher L.L.P., Washington, DC, Renee L. Thorne, Willkie Farr & Gallagher L.L.P., New York City, Rita Dudley Mitchell, Willkie Farr & Gallagher L.L.P., Washington, DC, Douglas Benjamin Bloom, Covington & Burling LLP, New York City, Allison B. Stein, Siddley Austin Brown & Wood, LLP, Los Angeles, CA, Andrew Arthur Ruffino, Covington & Burling LLP, New York City, Richard E. Drooyan, Munger, Tolles & Olson LLP, Los Angeles, CA, for Defendants.

ORDER

PAUL A. CROTTY, District Judge.

Plaintiff Edward H. Arnold ("Arnold") brings this action against Defendants KPMG ("KPMG"), an accounting firm, and Sidley Austin Brown & Wood ("Brown & Wood"), a law firm, for damages allegedly suffered when he bought tax shelters from KPMG with Brown & Wood's endorsement. The tax shelters, which were effectuated through the purchase and sale of securities, were designed to offset Arnold's income but were determined to be unlawful tax-avoidance schemes. Arnold now seeks relief for federal securities fraud, pursuant to Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5, promulgated thereunder, and for several state law causes of action including: breach of contract, breach of fiduciary duty, unjust enrichment and professional malpractice. Defendants KPMG and Brown & Wood move separately to dismiss Arnold's Third Amended Complaint ("Third Am. Compl.") alleging that his claims are time-barred and inadequately pleaded. KPMG moves to dismiss pursuant to Rule 12(b)(6) and Rule 9(b) of the Federal Rules of Civil Procedure, and Brown & Wood moves to dismiss pursuant to Rule 12(b)(6).

The Court held oral argument on the matter on March 6, 2008. (Transcript of Oral Argument, March 6, 2008 ("Tr.").) The Court ruled that: (1) Arnold's federal securities claims are time-barred by operation of the relevant statute of limitations (Tr. at 7-11); and

(2) Arnold's numerous state law claims merge into single claims for professional malpractice against each defendant (Tr. at 11-12). In light of these holdings, the Court heard oral argument as to: (1) whether the Court should exercise supplemental jurisdiction over the state law malpractice claims in light of the dismissal of the federal claims, and (2) whether the state law malpractice claims are time-barred under the statute of limitations. The Court now exercises its supplemental jurisdiction over the state law malpractice claims and dismisses them as time-barred.

SUMMARY OF FACTS[1]

Throughout the 1990s, the accounting firm KPMG designed and marketed tax strategies (shelters), which it sold to Arnold and hundreds of other high net worth individuals. The main purpose of the strategies was to create artificial losses for taxpayers to offset their otherwise taxable gains, thereby reducing their taxes. KPMG created three strategies: the Foreign Leveraged Investment Program ("FLIP"), the Offshore Portfolio Investment Strategy ("OPIS") and the Bond-Linked Issue Premium Structure ("BLIPS"). The complaint alleges that KPMG sold to Arnold one or more of these tax shelter schemes and that Arnold

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[1] Unless otherwise noted, the following facts are taken from the Third Amended Complaint, which the Court accepts as true for the purposes of this motion.

purchased and sold securities in order to effectuate and consummate those schemes between September 30, 1997 and December 31, 1997.[2] According to Defendants, KPMG sold Arnold the FLIP strategy in 1997. (Defendant KPMG's Memorandum in Support of its Motion at 2). The strategy involved a complex series of securities transactions in which Arnold purchased shares, options, and warrants in foreign entities in order to effectuate the tax shelters.

Arnold alleges that despite KPMG's knowledge that the tax shelters were unlawful, KPMG actively sold these strategies to the buying public and supplied Arnold and other taxpayers with opinion letters stating that the strategies would survive Internal Revenue Service ("IRS") scrutiny. Arnold received such an opinion letter from KPMG on May 13, 1998. (Plaintiff's Memorandum in Opposition to KPMG at 17.) In furtherance of the scheme, (and presumably, to boost confidence in the legitimacy of the tax strategies), KPMG not only provided its own opinion letters, but also negotiated with Brown & Wood to supply legal opinion letters. These legal opinion letters, issued to purchasers of the strategies, further assured the buyers that the tax strategies would "more likely than not" pass IRS scrutiny. The IRS rejected the strategies.

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[2] Arnold sold the majority of his shares in the scheme in December 1997. (Third Am. Compl. ¶¶ 77-84.)

Although Brown & Wood issued its opinion letters under the guise of providing independent legal advice, Arnold contends that the letters constituted nothing more than boilerplate approvals of the scheme, for which Brown & Wood received $50,000 per letter from KPMG. Arnold received an opinion letter from Brown & Wood on August 28, 1998. (Plaintiff's Memorandum in Opposition to Brown & Wood at 11.) Thus, Arnold alleges that KPMG and Brown & Wood, though purporting to work independently, were actually working together in a fraudulent scheme designed to produce millions of dollars in fees through the sale of the tax shelters. Indeed, Arnold alone paid KPMG and Brown & Wood more than $100,000 in fees in connection with the purchase of the strategies.

Arnold further alleges that the scheme did not end with the sale of the securities and the creation of the tax shelters. Instead, he reports that prior to August 2005, both KPMG and Brown & Wood repeatedly assured him that the tax shelters and related securities transactions were legal and legitimate and that KPMG and Brown & Wood "had done nothing wrong." (Third Am. Compl. ¶¶ 4, 5, 86.)

Ultimately, in August 2005, the strategies were revealed to be unlawful tax-avoidance schemes and were disavowed by the IRS. In "the largest criminal tax case ever filed," KPMG entered into a deferred prosecution agreement with the U.S. Department of Justice in which KPMG admitted to fraudulent conduct in the design and marketing of the tax

shelters. (Press Release, IRS, KPMG to Pay $456 Million for Criminal Violations (Aug. 29, 2005).)

On August 19, 2005, Arnold filed this suit against KPMG and Brown & Wood in the Southern District of New York on behalf of a putative class of plaintiffs who had participated in the OPIS and BLIPS tax strategies. The original Complaint, however, failed to include a claim based on the FLIP tax strategy, the strategy that Arnold actually purchased. After KPMG notified Arnold of this defect, Arnold filed his First Amended Complaint on September 14, 2005 to include claims based on FLIP. These first two complaints, however, did not include claims for federal securities fraud. Instead, federal jurisdiction was founded on the statute controlling class action complaints, 28 U.S.C. § 1332(d).

On December 23, 2005, this Court stayed Arnold's case in light of another class action against the same defendants, relating to the same tax strategies, in the District of New Jersey. *Simon v. KPMG,* No. 05 Civ. 3189(DMC), 2006 WL 1541048, at *1 (D.N.J. June 2, 2006). The *Simon* case settled, but Arnold opted out of the settlement agreement and instead chose to pursue his claims individually through the renewal of this action in the Southern District of New York.

Pursuant to Arnold's post-*Simon* request, the Court lifted the stay on this action and granted him leave to amend his complaint once again. Arnold filed a Second Amended Complaint on March 27, 2007,

maintaining individual state law causes of action against KPMG and Brown & Wood for breach of contract, breach of fiduciary duty, unjust enrichment, and professional malpractice. Thereafter, Defendants told Arnold that there was no basis for federal jurisdiction over the state law claims.[3] As a result, Arnold sought leave to amend – again – to include federal securities claims that could provide a basis for federal jurisdiction. Leave to amend was granted, and Arnold filed the Third Amended Complaint on June 12, 2007, alleging (for the first time) federal securities claims in addition to his state law claims. The Third Amended Complaint is now before the Court. Arnold seeks $5 million in damages.

DISCUSSION

1. Pleading Requirements

On a motion to dismiss, the court "must accept as true all of the factual allegations contained in the complaint," and construe the complaint in the light most favorable to the plaintiff. *Bell Atl. Corp. v. Twombly*, ___ U.S. ___ , ___ , 127 S.Ct. 1955, 1975, 167 L.Ed.2d 929 (2007) (citation and quotation marks omitted). But mere "formulaic recitation of the

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[3] The "Jurisdiction and Venue" section of the Second Amended Complaint recited that the same class action statute cited in the first two complaints, 28 U.S.C. § 1332(d), was the basis for federal jurisdiction, but the Second Amended Complaint raised only individual claims.

elements of a cause of action" will not suffice; instead, "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Id.* at 1965. To survive a motion to dismiss, courts require "enough facts to state a claim to relief that is plausible on its face." *Id.* at 1974; *see also Iqbal v. Hasty,* 490 F.3d 143, 157-58 (2d Cir.2007) (a plaintiff must "amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim *plausible.*").

2. Supplemental Jurisdiction

It is undisputed that the only basis for federal jurisdiction in this action rests on federal securities law, and Arnold's corresponding federal securities fraud claims. The Court dismissed the federal claims in its ruling on the record, but the Court retains the discretionary power to entertain Arnold's state law claims under its pendent, or supplemental, jurisdiction. Pendent jurisdiction "exists whenever there is a claim [arising under federal law], and the relationship between that claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional 'case.'" *United Mine Workers of Am. v. Gibbs,* 383 U.S. 715, 725, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966). In order to exercise this jurisdiction, "the state and federal claims must derive from a common nucleus of operative fact." *Id.*

Supplemental jurisdiction, however, need not be exercised in every case in which it exists. It has

"consistently been recognized that pendent jurisdiction is a doctrine of discretion, not of plaintiff's right." *Id.* at 726, 86 S.Ct. 1130; *see also Shalam v. KPMG,* No. 05 Civ. 3602(HB), 2005 WL 2139928, at *3 (S.D.N.Y. Sept. 6, 2005) ("Having dismissed the federal claims, the Court declines to exercise supplemental jurisdiction over the remaining state-law claims.") In deciding whether to exercise supplemental jurisdiction over state claims, the court should consider judicial economy, convenience and fairness to litigants, and whether the court must "resolve any novel or unsettled issues of state law." *Mauro v. S. New Eng. Telecomms. Inc.,* 208 F.3d 384, 388 (2d Cir.2000).

In this case, it is clear that an exercise of supplemental jurisdiction would be appropriate because both the federal and state claims arise from allegations of a common fraudulent scheme executed by the Defendants, and no novel issues of state law are implicated. Indeed, at oral argument both parties urged the Court to exercise its supplemental jurisdiction over Arnold's state law claims, notwithstanding the dismissal of the federal securities claims.[4] In light of these arguments, the protracted nature of this litigation, the Court's familiarity with the facts of the

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[4] *See* Tr. at 13-14 (Counsel for Brown & Wood arguing that the Court should exercise supplemental jurisdiction over the state law claims), Tr. at 18 (Counsel for KPMG concurring with Counsel for Brown & Wood), Tr. at 32-33 (Counsel for Arnold also arguing for the Court to exercise supplemental jurisdiction).

case and the claims asserted, and in the interests of judicial efficiency, economy of judicial resources, and a speedy resolution of the matter, the Court now exercises its supplemental jurisdiction and dismisses Arnold's state law claims.

3. The State Law Claims and the Statute of Limitations

Pursuant to the Court's ruling on the record, the only remaining state law claims against KPMG and Brown & Wood are claims for professional malpractice. An action to recover damages for professional malpractice, either legal or accounting, must be commenced within three years from the date of accrual. N.Y. C.P.L.R. § 214(6).[5] The date of accrual, in turn, is the date on which the malpractice occurred, not when it is discovered or when injuries are suffered. *See Glamm v. Allen,* 57 N.Y.2d 87, 93, 453 N.Y.S.2d 674, 439 N.E.2d 390, 393 (1982). Professional malpractice claims for accountants accrue when the client receives his work product, "since this is the point that a client reasonably relies on the accountant's skill and advice and, as a consequence of such reliance, can become liable for tax deficiencies." *Ackerman v. Price Waterhouse,* 84 N.Y.2d 535, 541, 620 N.Y.S.2d 318, 644 N.E.2d 1009,

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[5] N.Y. C.P.L.R. § 214 states, "the following actions must be commenced within three years: . . . (6) an action to recover damages for malpractice . . . regardless of whether the underlying theory is based in contract or tort; . . . ."

1012 (1994). With regard to legal malpractice, "[i]t is well-established that a cause of action for legal malpractice accrues on the date of the allegedly improper action, not on the date the malpractice was discovered," *Xie v. Lin*, No. 06 Civ. 142(HB), 2007 WL 423806, at *3 (S.D.N.Y. Feb. 7, 2007), "even if the aggrieved party is then ignorant of the wrong or injury." *Ackerman*, 84 N.Y.2d at 541, 620 N.Y.S.2d 318, 644 N.E.2d at 1012. The critical inquiry, then, is when the malpractice occurred – not when the client discovered it. *McCoy v. Feinman*, 99 N.Y.2d 295, 301, 755 N.Y.S.2d 693, 785 N.E.2d 714, 718 (2002).

In this case, Defendants argue that the three-year statute of limitations accrued when the opinion letters were issued. Arnold contends that because the fraudulent scheme was continuous, the claim did not accrue against either Defendant until KPMG revealed its fraudulent conduct by entering into a deferred prosecution agreement with the Department of Justice in August 2005. In the alternative, Arnold argues that the statute of limitations was tolled.

The Court rejects the argument that the appropriate date of accrual was August 2005; the claim for malpractice accrued when each Defendant issued its opinion letter. The opinion letter constitutes the professional work product on which Arnold relied, and the case law makes clear that a malpractice action accrues at the time of the malpractice, not later. *See, e.g., Xie*, 2007 WL 423806, at *3; *Glamm*, 57 N.Y.2d at 93, 453 N.Y.S.2d 674, 439 N.E.2d at 393. With respect to the accounting malpractice claim, the

statute of limitations began to run, at the latest, on May 13, 1998, when KPMG issued its formal opinion letter to Arnold. Similarly, the statute of limitations on the legal malpractice claim against Brown & Wood began to run on August 28, 1998, when it issued its opinion letter to Arnold. Applying the three-year statute of limitations to those dates, Arnold's claims were time-barred as of May 13, 2001, and August 28, 2001, respectively – nearly four years before the filing of the original complaint on August 19, 2005. Therefore, absent tolling, Arnold's malpractice claims are time-barred.

Arnold next argues that the statute of limitations was tolled, either under the doctrine of continuous representation or because of fraudulent concealment. Defendants, in contrast, maintain that there is no basis for tolling.

(1) Tolling Due to Continuous Representation

The continuous representation doctrine holds that the statute of limitations on a legal malpractice claim "is tolled while the attorney continues to represent the client as to the same matter underlying the malpractice claim." *Kvetnaya v. Tylo,* 49 A.D.3d 608, 854 N.Y.S.2d 425, 426 (2d Dep't 2008) (citing *Shumsky v. Eisenstein,* 96 N.Y.2d 164, 167-68, 726 N.Y.S.2d 365, 750 N.E.2d 67, 70-71 (2001)). Continuous representation requires that the parties possess "a mutual understanding of the need for further

representation on the specific subject matter underlying the malpractice claim." *Id.*; *see also Williamson ex rel. Lipper Convertibles, L.P. v. Pricewaterhouse-Coopers,* 9 N.Y.3d 1, 9-10, 840 N.Y.S.2d 730, 872 N.E.2d 842, 847 (2007). The parties must explicitly contemplate that the professional relationship continue, *Williamson,* 9 N.Y.3d at 10, 840 N.Y.S.2d 730, 872 N.E.2d at 847, and that the continued representation occur "in connection with the particular transaction which is the subject of the action," *Mitschele v. Schultz,* 36 A.D.3d 249, 253, 826 N.Y.S.2d 14, 18 (1st Dep't 2006) (citation omitted).

Arnold argues that he had such a continuing professional relationship with the Defendants, and that the statute of limitations should therefore be tolled. He fails, however, to adequately plead this assertion. Arnold contends that "[p]rior to August 2005, KPMG and [Brown & Wood] repeatedly assured Plaintiff that the tax shelters and related securities transactions were legitimate and legal, and that KPMG and [Brown & Wood] had done nothing wrong." (Third Am. Compl. ¶ 4.) These "repeated assurances," however, do not constitute "continuous representation" absent the explicit and mutual agreement to remain in a professional relationship. *Williamson,* 9 N.Y.3d at 10, 840 N.Y.S.2d 730, 872 N.E.2d at 847. Arnold fails to allege the requisite agreement existed with regard to the tax scheme here; he sets forth no allegations that the parties had a specific and mutual understanding that their professional relationship continue beyond the purchase

of the schemes and the receipt of the opinion letters. Accepting the allegations as true and viewing them in the light most favorable to Arnold, the Court finds that Arnold has failed to adequately allege continuous representation. Arnold's bald allegations of repeated denials of wrongdoing, standing alone, are insufficient to toll the statute of limitations on the basis of continuous representation.

(2) Tolling Due to Fraudulent Concealment

Alternatively, Arnold argues that the statute of limitations on a malpractice claim may be tolled when there is fraudulent concealment of the wrongdoing, but New York law is precisely the opposite. *Fisher v. Reich,* No. 92 Civ. 4158(MBM), 1995 WL 23966, at *10 (S.D.N.Y. Jan. 10, 1995). *Fisher v. Reich* holds that under New York law a claim for malpractice is not tolled by fraudulent concealment. *Id.* It states that "because New York courts have rejected the proposition that fraudulent concealment tolls the statute of limitations *in professional malpractice cases,* plaintiffs cannot use this doctrine to preserve their malpractice claim." *Id.* (emphasis added) (citing "*Siegel v. Kranis,* 52 Misc.2d 78, 274 N.Y.S.2d 968, 970 (N.Y.Sup.Ct.1966), *rev'd on other grounds,* 29 A.D.2d 477, 288 N.Y.S.2d 831 (N.Y.App.Div.1968) ("New York State takes the view that fraudulent concealment does not toll the statute of limitations"); *Tulloch v. Haselo,* 218 A.D. 313, 218 N.Y.S. 139, 142-43 (1926) (fraudulent concealment in malpractice action merely goes to the enhancement of

damages, but does not extend the statute of limitations).")

Even if fraudulent concealment could toll the statute of limitations on the professional malpractice claims, Arnold has not pleaded it with the requisite specificity. Courts in this district have made clear that plaintiffs asserting fraudulent concealment as a basis for tolling must "specify in [the] pleadings: (1) what the omissions were; (2) the person responsible for the failure to disclose; (3) the context of the omissions and the manner in which they misled the plaintiff, and (4) what defendant obtained through the fraud." *Grynberg v. Eni S.p.A.*, No. 06 Civ. 6495(RLC), 2007 WL 2584727, at *4 (Sept. 5, 2007). It is not enough for a plaintiff to rely on general statements describing a broad conspiracy. *See Mahoney v. Beacon City Sch. Dist.*, 988 F.Supp. 395, 400 (S.D.N.Y.1997) ("The evidence submitted by plaintiff to support a fraudulent concealment claim must not be conclusory, and must establish a conspiracy or other fraudulent wrong that precluded plaintiff's possible discovery of the harm she suffered.") (citing *Pinaud v. County of Suffolk*, 52 F.3d 1139 (2d Cir.1995)).

Arnold does not specifically allege that KPMG or Brown & Wood concealed their fraud from him directly; he merely contends that they engaged in a large-scale conspiracy to defraud the IRS, government investigators, and "their clients, including Plaintiff." (Third Am. Compl. ¶ 5). For example, Arnold claims that "numerous KPMG executives and

partners employed various means to fraudulently conceal the true facts relating to the shelters, including failing to register them with the IRS, preparing tax returns that disguised the shelters' effects, and using sham attorney-client privilege claims to hide their actions from the government and their clients." (Third Am. Compl. ¶ 5). At no point, however, does Arnold allege a single conversation or other communication between a representative of KPMG or Brown & Wood and himself, nor does he provide the date of a communication, identify a speaker, or proffer the exact contents of an interaction. Bald, conclusory allegations of a vast conspiracy are insufficient; Arnold has failed to adequately plead his claim of fraudulent concealment.

4. Denial of Request to Re-Plead

Finally, Plaintiff requests permission to re-plead yet again. In defense of this request, Arnold argues that since the first three amendments resulted from Defendants' suggestions of defects, he is now entitled to the benefit of the Court's impressions on the adequacy of the pleadings.[6] Pleadings, however, are not essays to be graded by the District Court with

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[6] At oral argument, Plaintiff's counsel stated that "we would respectfully request an opportunity to amend for the following reasons: [number one], this is the first time that we have had the benefit of the Court's comments relating to the sufficiency or insufficiency of the complaint. . . . [and] [n]umber two, this is potentially a case dispositive motion." (Tr. at 31.)

allowances for editing and revision. The fact that leave to amend "shall be freely given when justice so requires," Fed.R.Civ.P. 15(a), does not mean that leave to re-plead is to be granted in perpetuity. There is a reason for the statute of limitations – it is repose. It has been years since the alleged fraud occurred and Plaintiff has been allowed his initial complaint and three amendments. Any amendments would appear to be futile, and now, ten years after the alleged wrong, it is time to bring this matter to a close.

In *Foman v. Davis,* 371 U.S. 178, 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962), the Supreme Court specifically articulated that "repeated failure to cure deficiencies by amendments previously allowed" constitutes a reasoned basis on which to deny a motion to amend.[7] Arnold has repeatedly failed to cure his deficiencies here. There have been multiple opportunities for pleading, and one opportunity to recover as part of the *Simon* class action settlement. The direction that amendments shall be "freely given" does not contemplate serial adjustments to the pleadings based on a federal court's coaching and guidance. His request for leave to re-plead is denied.

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[7] The Supreme Court stated in full, "[i]n the absence of any apparent or declared reason - such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. – the leave sought should, as the rules require, be 'freely given.'" *Id.*

CONCLUSION

For the reasons stated above and on the record on March 6, 2008, Defendants' motions to dismiss are GRANTED. The Clerk of Court is directed to terminate this action and enter judgment.

SO ORDERED.